

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

ORIGINAL

77-7098

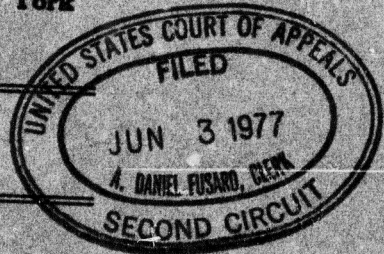
United States Court of Appeals
For the Second Circuit

RICHARD I. CLARK, as Executor of the
Estate of BERNICE C. GRUPE,
Plaintiff-Appellee,
against

JOHN LAMULA INVESTORS, INC. and
JOHN J. LAMULA,
Defendants-Appellants.

On Appeal from a Final Judgment of the United States
District Court for the Southern District of New York

BRIEF OF PLAINTIFF-APPELLEE



SILBERFELD, DANZIGER & BANGSER
Attorneys for Plaintiff-Appellee
230 Park Avenue
New York, New York 10017
(212) 867-6500

ROBERT M. BLUM
ROBERT M. DUBOW
Of Counsel



TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES.....	i
STATEMENT OF THE ISSUES PRESENTED FOR REVIEW.....	1
STATEMENT OF THE CASE	
Nature of the Case.....	3
Statement of Facts.....	6
ARGUMENT.....	22
POINT I - Since Defendants Failed to Raise Any Objection Before the Jury Retired to Either the Jury In- structions or the Special Inter- rogatories Submitted to Them, Defendants Thereby Waived Their Right to Claim that the Instruc- tions or Interrogatories were Inadequate.....	22
POINT II - The Findings of the Jury Amply Support Judgment for Plaintiff for the Fraud Committed by Defendants in (a) Recommending to Her Debentures which They Knew to be Unsuitable for Her, (b) Omitting to Inform Her of Other Material Matters with Intent to Deceive Her, and (c) Deliberately Overcharging Her for the Debentures with Intent to Deceive Her.....	30
POINT III - The Court Below Properly Applied the Law Respecting Defendants' Pricing of the Debentures on Their Sale to Plaintiff; and the Jury Properly Found that Defend- ants' Pricing Practices were Wrongful and Fraudulent.....	43
POINT IV - Plaintiff's Damages were Properly Measured. In any Event, the Measure of Damages Applied by the Court was Explicitly Agreed to by Defendants.....	48

POINT V

- No Claim of Prejudice was Raised at Trial Respecting Use of the Market Term "Junk Bonds". For this Reason, and Because the Term was Clearly Not Prejudicial to Defendants, No Plain Error was Committed by the Trial Court..

53

CONCLUSION.....

57

SUPPLEMENT NO. 1.....

58

SUPPLEMENT NO. 2.....

60

TABLE OF AUTHORITIES

Page

I. CASES

<u>Abrahamson v. Fleschner</u> , 392 F. Supp. 740 (S.D.N.Y. 1975).....	50
<u>Affiliated Ute, Citizens of Utah v. U.S.</u> , 406 U.S. 128 (1972).....	31, 33
<u>Architectural League of N.Y. v. Bartos</u> , 404 F. Supp. 304 (S.D.N.Y. 1975).....	38
<u>Arthur Lipper Corp. v. S.E.C.</u> , ____ F.2d ____, CCH Fed. 2d L. Rep. ¶95,796 (2d Cir. 1976).....	35
<u>Atlantic & Gulf Stevedores v. Ellerman Lines</u> , 369 U.S. 355,82 S. Ct. 780 (1962).....	26
<u>Black v. Riker-Maxon Corp.</u> , 401 F. Supp 693 (S.D.N.Y. 1975).....	27
<u>Blackie v. Barrack</u> , 524 F.2d 891 (9th Cir. 1975).....	50
<u>Boren & Co.</u> , 40 S.E.C. 217 (1960).....	44
<u>Brown v. Coates</u> , 253 F.2d 36 (D.C. Cir. 1958).....	47
<u>Bush v. Bruns Nordeman & Co.</u> , CCH Fed. Sec. L. Rep., ¶93,675 (S.D.N.Y. 1972).....	38
<u>Buttrey v. Merrill Lynch</u> , 410 F.2d 135 (7th Cir. 1969).....	38
<u>C. Albert Sauter Co., Inc. v. Richard S. Sauter Co., Inc.</u> , 368 F. Supp. 501 (E.D. Pa. 1973).....	24
<u>Cant v. A. G. Becker & Co., Inc.</u> , 379 F. Supp. 972 (N.D. Ill. 1974).....	41
<u>Charles Hughes & Co. v. S.E.C.</u> , 139 F.2d 434 (2d Cir. 1933).....	32, 44, 45
<u>Chasins v. Smith, Barney & Co.</u> , 438 F.2d 1167 (2d Cir. 1970).....	49, 50
<u>Collins v. Penn Central Transportation Co.</u> , 497 F.2d 1296 (2d Cir. 1974).....	31
<u>Colonial Realty Corp. v. Bache & Co.</u> , 358 F.2d 178 (2d Cir. 1966), <u>cert. den.</u> 385 U.S. 817 (1966).....	37, 38
<u>Cote v. Estate of Butler</u> , 518 F.2d 157 (2d Cir. 1975).....	23

	<u>Page</u>
<u>Cutmer v. Fried</u> , 373 F. Supp. 4 (S.D.N.Y. 1974).....	51
<u>Derry v. Peck</u> , 14 App. Cas. 337,374 CH. L. 1889).....	34
<u>Ernst & Ernst v. Hochfelder</u> , 425 U.S. 185, 96 S. Ct. 1375 (1976).....	22, 33, 34, 3
<u>Evans v. Kerbs & Co.</u> , 411 F. Supp. 616 (S.D.N.Y. 1976).....	38
<u>Franklin Savings Bank v. Levy</u> , ____ F.2d ____, CCH Fed. Sec. L. Rep. ¶95,902 (2d Cir. 1977).....	32, 35
<u>Gallick v. Baltimore & Ohio R. Co.</u> , 372 U.S. 108,83 S. Ct 659 (1963).....	26
<u>Handley Investment Co. v. S.E.C.</u> , 354 F.2d 64 (10th Cir. 1965).....	56
<u>Hanley v. S.E.C.</u> , 415 F.2d 589 (2d Cir. 1969).....	32
<u>Harris v. American Investment Co.</u> , 523 F.2d 220 (8th Cir. 1975), <u>cert. den.</u> 423 U.S. 1054, 96 S. Ct. 784 (1976).....	41
<u>Hughes v. S.E.C.</u> , 174 F.2d 969 (D.C. Cir. 1949).....	32
<u>Jo Ann Holmes at Bellmore v. Dworetz</u> , 25 N.Y. 2d 112 (1969).....	34
<u>Lanza v. Drexel & Co.</u> , 479 F.2d 1277 (2d Cir. 1973).....	34
<u>Jones & Laughlin Steel Corp. v. Matherne</u> , 348 F.2d 394 (5th Cir. 1965).....	26
<u>Lehrmann v. Merrill Lynch</u> , 175 N.Y.L.J. No. 36, p. 7 (Sup. N.Y. 2/24/75).....	47
<u>Merritt, Vickers, Inc. v. S.E.C.</u> , 353 F.2d 293 (2d Cir. 1965).....	44
<u>Naftalin & Co., Inc.</u> , Sec. Exch. Act Rel. No. 7220 (1964).....	44, 45
<u>Napolitano v. Compania Sud Americana de Vapores</u> , 421 F.2d 382 (2d Cir 1970).....	55
<u>Neill v. David A. Noyes & Co.</u> , 416 F. Supp. 78 (N.D. Ill. 1976).....	39
<u>Ocrant v. Dean Witter & Co.</u> , 502 F.2d 854 (10th Cir. 1974).....	39

	<u>Page</u>
<u>Opper v. Hancock Securities Corporation</u> , 250 F. Supp. 668 (S.D.N.Y. 1966), <u>aff'd</u> 367 F.2d 157 (2d Cir. 1966).	34, 44, 46
<u>Parsons v. Hornblower & Weeks</u> , CCH Fed. Sec. L. Rep. ¶95,885 (M.D.N.C. 1977).....	39
<u>Peter Eckrich and Sons, Inc. v. Selected Meat Co.</u> , 512 F.2d 1164 (7th Cir. 1975).....	55
<u>Pittsburgh Coke & Chemical Co. v. Bollo</u> , 421 F. Supp. 908 (E.D.N.Y. 1976).....	41
<u>Plunkett v. Dominick & Dominick</u> , CCH Fed. Sec. L. Rep. ¶95,728 (D.C. Conn. 1976).....	40
<u>Rubin v. U.S.</u> , 380 F. Supp. 1176 (W.D. Pa. 1974), <u>aff'd</u> 515 F.2d 507.....	24
<u>Rolf v. Blyth Eastman Dillon & Co., Inc.</u> , CCH Fed. Sec. L. Rep. ¶95,843 (S.D.N.Y. 1/18/77).....	38
<u>Samuel B. Franklin & Co. v. S.E.C.</u> , 290 F.2d 719 (9th Cir. 1961), <u>cert. den.</u> 368 U.S. 889, 82 S. Ct. 142 (1961).....	56
<u>Sanders V. John Nuveen & Co. Inc.</u> , CCH Fed. Sec. L. Rep. ¶96,030 (7th Cir. 4/22/77).....	34
<u>Sarlie v. E. L. Bruce Co.</u> , 265 F. Supp. 371 (S.D.N.Y. 1967).....	50
<u>S.E.C. v. Charles A. Morris & Assoc., Inc.</u> , 396 F. Supp. 1329 (W.D. Tenn. W.D. 1973).....	32
<u>Shearson Hammill & Co.</u> , S.E.C. Sec. Act Rel. No. 7743, CCH F. Sec. L. Rep. ¶77,306 (1965).....	45
<u>Starkman v. Seroussi</u> , 377 F. Supp. 518 (S.D.N.Y. 1974).	38
<u>State Street Trust Co. v. Ernst</u> , 278 N.Y. 104 (1939), <u>rearg. den.</u> , 278 N.Y. 704.....	34
<u>Taxi Weekly, Inc. v. Metro Taxicab Bd. of Trade</u> , 539 F.2d 907 (2d Cir. 1976).....	31
<u>Turchio v. D/S A/S Den Norske Africa</u> , 509 F.2d 101 (2d Cir. 1974).....	24
<u>Ultramares Corp. v. Touche</u> , 225 N.Y. 170 (1931).....	34
<u>U.S. v. Alsondo</u> , 486 F.2d 1339 (2d Cir. 1973).....	55
<u>U.S. v. H. M. Branson Distributing Co.</u> , 398 F.2d 929 (6th Cir. 1968).....	24

	<u>Page</u>
<u>Van Gemert v. Boeing Co.</u> , 520 F.2d 1373 (2d Cir 1975).....	38
<u>Utah State University v. Bear, Stearns & Co.</u> , 549 F.2d 164 (10th Cir. 1977).....	39
<u>Zeller v. Bogue Electric Manufacturing Corp.</u> , 476 F.2d 795 (2d Cir. 1973).....	51
 II. <u>STATUTORY AND QUASI-STATUTORY MATERIAL</u>	
F. R. Civ. P. 49 (a).....	22, 25, 26
F. R. Civ. P. 51.....	22, 47
Fed. Rules of Evidence 103(a).....	40, 53
Fed. Rules of Evidence 103(d).....	54
NASD Rules of Fair Practice, Article III, Sec. 2.....	36, 37, 39
NASD Rules of Fair Practice, Article III, Sec. 4.....	43
NASD Rules of Fair Practice, Article III, Sec. 5.....	46
Rule 10b-5, 17 C.F.R. §240.10b-5.....	31, 33
Section 17(a) of the 1933 Act, 15 U.S.C. §77q(a).....	31
Section 28(a) of the 1934 Act, 15 U.S.C. §78bb.....	50
 III. <u>SECONDARY MATERIAL</u>	
<u>Bromberg Securities Law: Fraud -- SEC Rule 10b-5</u>	32, 44, 50
Butkowsky, "Remedies for Violations of Rule 10b-5 in General," in P.L.I. <u>The 10B Series of Rules</u> , 1974.....	50
CCH NASD Manual.....	43, 46
Goldwasser, " <u>Ernst & Ernst v. Hochfelder: an Anti-Landmark Decision</u> ", 22 N.Y. Law School L. Rev. (1976).....	34
Lowenfels, <u>Implied Liabilities Based Upon Stock Exchange Rules</u> , 66 Colum. L. Rev. 12 (1966).....	37
Lowenfels, <u>Private Enforcement in the Over-the-Counter Securities Markets: Implied Liabilities Based on NASD Rules</u> , 51 Cornell L.Q. 663 (1966).....	37
<u>Moore's Federal Practice</u> , 2d Ed.....	27

	<u>Page</u>
<u>Note, Implied Civil Liability Arising From Violation Of the Rules of the NASD, 8 Loyola L.A. L. Rev. 151 (1975).....</u>	38
Patrick, "New Directions and Recent Developments in Securities Litigation", in Eighth Institute on Securities Regulations P.L.I. Handbook No. 224 at p. 276 (1976).....	34
<u>Weinstein's Evidence.....</u>	54, 55

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. May defendants, having failed to raise any objection before the jury retired to either the instructions to the jury or the special interrogatories submitted to them under Rule 49(a), F.R.Civ.P., now seek reversal because of alleged inadequacies in both the instructions and the interrogatories?

2. Was it reversible error for the court to grant judgment for plaintiff for violation of the anti-fraud provisions of the federal securities laws, upon specific jury findings that (i) the securities sold by defendants to plaintiff were known by defendants to be unsuitable for plaintiff when defendants recommended them to her, (ii) defendants intended plaintiff to rely on such recommendation and she did so rely, (iii) defendants concealed from plaintiff other information relevant to her investment decision, intending to deceive her, and (iv) plaintiff would not have bought the securities if she had been given such information?

3. Was it reversible error for the court to grant judgment for plaintiff for violation of the anti-fraud provisions of the federal securities laws, upon specific

jury findings, "by clear and convincing evidence," that defendants purchased the bulk of the securities for the specific purpose of selling them to plaintiff, that defendants charged plaintiff an excessive amount for the securities they sold her, concealing from her their profit on the transaction, and that all this was done with intent to deceive plaintiff?

4. (a) Were plaintiff's damages properly determined to be the difference between the amount she paid for the securities fraudulently sold her and the proceeds she received when she sold them upon discovery of the fraud?

(b) In any event, having expressly accepted the measure of damages before the jury was discharged, can defendants challenge it now?

5. Did the court commit reversible error, in the absence of any objection by defendants' counsel during the trial claiming prejudice, by permitting plaintiff to prove through expert witnesses that securities of low quality like those at issue are known as "junk bonds" in Wall Street parlance?

Plaintiff-appellee believes that issue No. 4(a) should be answered "yes"; and that all of the others (as well as 4(b)) should be answered "no."

STATEMENT OF THE CASE

Nature of the Case

Plaintiff Bernice C. Grupe ("Mrs. Grupe") asserted claims arising from the sale to her of certain securities by defendants John Lamula Investors, Inc. ("JLI") and its president and principal stockholder, defendant John J. Lamula ("Mr. Lamula"). The complaint charges that defendants violated section 17(a) of the Securities Act of 1933 (the "1933 Act"), sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 (the "1934 Act") and various rule promulgated thereunder, as well as Article III of the Rules of Fair Practice of the National Association of Securities Dealers ("NASD").* Under pendent jurisdiction principles, common law fraud and breaches of fiduciary duty were also charged.

The gravamen of the misconduct charged, as shaped by the pre-trial order, was:

1. Defendants recommended to Mrs. Grupe over-the-counter convertible debentures of poor quality,

* 15 U.S.C. §77q(a); 15 U.S.C. §§78j(b) and 78o(c) (1); Rules 10b-3, 10b-5, 15c1-2 and 15c1-7 (17 C.F.R. §§ 240.10b-3 and 240.10b-5, 240.15c1-2 and 240.15c1-7; and Sections 2, 4, 15 and 18, Article III, Rules of NASD. Some of these provisions of law and regulations are set forth in the addendum attached to this brief as Supplement No. 1.

knowing that such securities were unsuitable for Mrs. Grupe.

2. Defendants concealed from plaintiff the existence of more suitable investment alternatives, the poor ratings of the securities, the thinness of the market for them, the fact that JLI was a market maker for each issue of debentures involved, and other information relevant to an informed investment decision, with intent to deceive her.

3. Relying on defendants' recommendation, Mrs. Grupe purchased the debentures, all of which were sold to her by JLI acting as principal.

4. JLI had not held most of the debentures thus sold in its own inventory; but purchased them at the time of resale to Mrs. Grupe for the sole purpose of selling them to her in a risk-free transaction.

5. In every instance, without so advising Mrs. Grupe, defendants sold the debentures to Mrs. Grupe at prices vastly in excess (i) of what JLI had itself paid to acquire them, and (ii) of the fair market value thereof; and did so in order to obtain an unlawful profit.

6. When Mrs. Grupe learned the unsuitable nature of the debentures thus sold to her, and the deceptions

practiced upon her, she demanded rescission. When defendants refused, she promptly sold the entire portfolio at their then market values, thereby suffering a loss of \$31,350 on the purchase-sale transactions.

Defendants denied the material allegations of the complaint. At the close of a six-day trial, the court (Hon. Gerard L. Goettel) submitted written interrogatories to the jury pursuant to Rule 49(a), F.R.Civ.P. Those interrogatories dealt with liability only. In their answers to the interrogatories, the jury found:

1. By a preponderance of the proofs, that defendants recommended that Mrs. Grupe purchase securities which they knew or believed were unsuitable; and that they concealed other material facts relevant to a sound investment decision, intending thereby to deceive Mrs. Grupe;

2. By clear and convincing proofs, that Mrs. Grupe was almost entirely dependent on defendant Lamula for determination of the price at which she bought the debentures, and that defendant JLI charged her an excessive amount for the securities with intent to deceive her;

3. Neither Mrs. Grupe nor the brokerage firm through which she promptly disposed of the securities

had acted unreasonably in selling them.

On such findings the court entered judgment for plaintiff in the amount of \$31,350 adjusted to credit defendants with the net interest plaintiff had received on the debentures. It denied motions (i) by plaintiff to submit to the jury her claim for punitive damages and for the reasonable expenses of her action, pursuant to section 11(e) of the 1933 Act; and (ii) by defendants for judgment n.o.v. or a new trial.

Defendants have appealed the judgment and the order denying their said motions.

Statement of Facts*

The proofs at trial showed the following:

Mrs. Grupe, a woman in her late fifties, separated from her second husband in July 1973 (A-65). She received a net lump-sum settlement from him of \$138,000, which was paid to her in full that fall (A-152-3). This settlement sum constituted plaintiff's only asset of significant value (A-176).

From this \$138,000 sum, Mrs. Grupe purchased a

* References to the Joint Appendix are by the letter "A" and reference to page number. References to certain exhibits are by the letter "E" and reference to page number in the Supplemental Joint Appendix of Exhibits.

\$100,000 certificate of deposit of the Bank of New York, Albany, due to mature on July 15, 1974 (A-176-7), made certain gifts to her sons (A-153, 164), and held the balance in her checking and savings accounts for household and ordinary living expenses and emergencies (A-292).

Plaintiff's three children by her previous marriage were adult; she had no dependents (A-152). An English and speech teacher by profession, she obtained a position in Albany on the staff of the New York State Senate Majority Leader as a specialist in educational matters (A-170-1). Her position was a temporary one, due to end when the Legislature rose (A-171); and plaintiff therefore cast about for some way to assure herself of the minimum income which she needed for ordinary living purposes.

A colleague of hers, Dorothy Emerson, also employed by the State Senate, recommended that she consult Mr. Lamula (A-173). Miss Emerson told plaintiff that Lamula had been handling her own investments for several years, that she had been associated with him in political ventures for more than thirty years, and that he was quite trustworthy (A-384-7).

This recommendation was followed by a series of meetings between Mrs. Grupe and Mr. Lamula to discuss possible investments. All of these meetings occurred between mid-March and mid-May 1974; all occurred in the suite of

rooms retained by Miss Emerson at the DeWitt Clinton Hotel in Albany, where plaintiff also then lived; and Miss Emerson was always present (A-66).

Mrs. Grupe advised Mr. Lamula that she held as her sole source of investment funds the \$100,000 certificate of deposit maturing in July, that her prime investment goal was securing a safe and steady income of approximately \$1,000 monthly on which to live, and that she needed safe investments for her money (A-178, 181, 390). She told Lamula that she was wary of investing in stocks, because her family suffered substantial losses in the Great Depression (A-178). Mr. Lamula agreed that stocks were not suitable for her. He warned her that banks could fail (A-390-1), and recommended that she invest her entire available funds in convertible debentures issued by certain companies which, although small, and virtually unknown, were companies with which he was personally quite familiar.

Early in the series of meetings, Mr. Lamula identified ten or eleven issues of convertible debentures which he recommended that plaintiff purchase for her portfolio. He recommended no other purchases to her, and no other type of securities for her to consider, at any time during the two months which preceded the purchase in question (A-896, 182, 398-401).

Mrs. Grupe asked Mr. Lamula about the ratings of debentures; Mr. Lamula told her that he did not regard the ratings given by Moody's and Standard and Poor's as relevant considerations, claiming that he himself, since he had an intimate knowledge of these issues and issuers, was able to give them excellent ratings (A-394, 770).

At the series of meetings Mr. Lamula provided plaintiff with some information about each of the debenture issues: he appears to have discussed their sinking fund features, the rates of redemption, and the product lines of the companies (A-297-8). For her part, Mrs. Grupe told Mr. Lamula repeatedly that she was totally without knowledge about the market and investments (A-299); that she had confidence in Lamula and believed in him; and that if he recommended the securities for her, she was willing to trust such recommendations without understanding the subject matter (A-299, 300).

There was testimony, however, that Mr. Lamula did not disclose to her that all of the debentures he recommended to her (which she ultimately purchased) were issues for which defendants were market makers (A-183-4, 418); and that there were no more than two or three market makers and in some instances only one other market maker besides JLI. Nor did he disclose that most of the companies issuing the

debentures were in serious economic difficulty, and had shown net losses for recent or current periods, had not declared dividends (in most cases) on the underlying common stock in recent years; that the common stock of each of these companies was then trading at so low a price as to make the convertibility feature of the debentures meaningless; that the market for every one of the debenture issues was so thin that subsequent sale of each such issue before call or maturity virtually assured the realization of a loss; that JLI would be acting as a principal and not as a broker in the establishment of plaintiff's portfolio; that major litigation creating substantial contingent liabilities was pending as to several of the companies; and that all of the debentures were either without ratings from Moody's and Standard and Poor's because of their poor condition or the unavailability of information, or else were rated as high risk or "outright speculation" securities.*

Mr. Lamula further proposed to plaintiff that she

* Each category of information described in the footnoted sentence was either testified to at the trial by Mr. Lamula himself, or by Harry C. Rowney, plaintiff's expert witness on suitability; or was admitted by defendants in response to plaintiff's Request for Admissions of Facts. The specific appendix references to each such category are copious, and are therefore collected in Supplement No. 2 to this brief. The ratings (stipulated to by counsel) are set forth at A-37-38.

could obtain the portfolio without waiting for her certificate of deposit to mature, by borrowing against it from the bank which issued it -- a procedure which Mrs. Grupe followed under Mr. Lamula's guidance (A-189-190).

On April 1, 1974, defendants held little or no inventory in virtually all of the debenture issues which they were recommending to plaintiff (Pre-Trial Order, items 11 to 21, A-69-75). They were in fact maintaining a "work-out" market* for most of them. By mid-May, the portfolio items had been settled upon, and defendants were armed with complete discretion to allocate plaintiff's available \$100,000 among the ten or eleven issues which they had selected for her (A-896-7). Instead of acting as brokers for plaintiff, defendants chose to act as principal and market maker in assembling the necessary inventory to cover the intended sales of the portfolio items to plaintiff (Pre-Trial Order, item 9; A-67).

On May 21, 1974, JLI purchased 120 of the 170 debentures they had earmarked for plaintiff and on the same day sold plaintiff the entire \$170,000 face amount of con-

* Defined by the expert Rowney as a condition in which a market-maker does not maintain an on-going inventory, but instead goes into the market to buy only when it has already secured a customer's purchase order (A-629).

vertible debentures they had thus assembled (A-897-8).*

The testimony of Mr. Lamula and his secretary, Mrs. Vena, as well as exhibits from the records of JLI, indicated that defendants systematically disregarded the market prices quoted by other market makers (and by JLI itself in several instances) in the daily quotations circulated by the National Quotation Bureau, Inc. (the "yellow sheets"); and charged plaintiff prices which were marked up by an average of 11.78 percent over the current market price indicated therein (A-681, 688-9).**

Such testimony and exhibits further tended to show that defendants had forged, on the backs of the individual order tickets respecting the sale of each debenture issue to plaintiff, the purported information as to telephonic quotations received from other market makers on the sale date (A-681-9). In point of fact, every one of the indicated market

* Mr. Lamula's office diary showed such sale on May 21, 1974 (A-632). The confirmation advices issued to Mrs. Grupe indicated a May 22, 1974 dated (A-650). The order tickets themselves were time-stamped May 23, 1973, a clearly erroneous date (A-692). The JLI office copies of the confirmation advices had been corrected from May 22 to May 23, 1974. (A-650) In any case, it was obvious that selection of a sales date was "totally within the control of defendant" (A-679).

** Defendants submitted no proofs tending to support either the relation to fair market value of the prices JLI charged plaintiff for the debentures, nor to justify the amount of the mark-up taken by JLI.

makers who had inserted quotations in the yellow sheets for the relevant dates did so at prices significantly less than those attributed to them on the backs of JLI order tickets (plaintiff's exhibit 165, E-11). Such testimony and exhibits also showed that defendants had back-dated the order tickets (A-692); and had post-dated the confirmation slips sent to Mrs. Grupe (A-676), thereby creating an erroneous appearance of the passage of time between JLI's purchase of most of the debentures and their sale by JLI to Mrs. Grupe. The difference between defendants' acquisition cost and the proceeds of the sales to plaintiff -- JLI net profit -- was \$10,890 (A-86). (Such profit notwithstanding, JLI showed about \$100,000 net loss for the year 1974 (A-724-5).)

Plaintiff was unaware of any of these goings-on. Aside from the fact that about \$100,000 worth of these various securities were going to be bought in her name, plaintiff appears not to have had any information about prices until May 29, 1974 (A-194-5). On or about that day Lamula contacted her in Albany, handed her a handwritten tally sheet (plaintiff's exhibit 20, E-5), advised her that she had acquired a portfolio and that she owed him \$99,804.45,*

* Inclusive of accrued interest. The principal amount, as stated above, was \$96,700. See tabulation, Pre-Trial order item 10, A-67-8.

which must be paid by the following day. He escorted her to the bank and assisted her in taking out a \$100,000 loan against her \$100,000 certificate of deposit, the proceeds of which were thereupon paid by plaintiff to defendant (plaintiff's exhibit 15, E-3).

Confirmations of the transactions were received by plaintiff by mail in due course. Plaintiff, totally unfamiliar with securities market matters, did not know how to read, and in fact did not read, the confirmations (A-205-207).

Under trade date of June 3, 1974, defendants sold to plaintiff, for her account, a further amount of one of the debenture issues previously placed by them in her portfolio (A-68; plaintiff's exhibit 22, E-77). Defendants did not advise Mrs. Grupe of such further transaction in advance, and the first that she learned of it was through the receipt of an additional confirmation and bill for a further \$4,136.67 (A-216-17). She paid the additional amount (A-225).

Plaintiff's relations with Lamula continued upon an excellent footing. She consulted him by telephone and letter respecting a variety of matters relating to her financial affairs, and sought his help in obtaining a continuance of her government employment. Lamula apparently

paid close attention to her interests in such matters, and the correspondence between them indicates the friendly regard between them (see, e.g., A-226, 230, 238).

On or about July 10, 1974, Mrs. Grupe received a confirmation and bill from defendants for yet another transaction in her account, whereby defendants as market makers sold her \$10,000 more low-grade convertible debentures (A-235-6). Again, plaintiff claims to have had no knowledge of such transaction in advance. Nevertheless, Mrs. Grupe paid JLI the additional sum of \$4,752.50, invading her savings account in order to do so (A-239). Altogether, defendants sold to Mrs. Grupe \$185,000 face amount of low quality convertible debentures (A-678) for an aggregate purchase price (exclusive of accrued interest) of \$105,050.

In mid-July plaintiff's sister and brother-in-law discussed with plaintiff her securities investments (A-242-3). As a result of the discussion, Mrs. Grupe was alerted to the quality of the debentures she had been sold. She and her sister at once examined the debenture ratings at her local public library (A-244; defendants' exhibits A-H, E-34-37).

Alarmed, Mrs. Grupe hurried to New York City, bringing with her the securities themselves (A-252).

Upon arrival in New York, Mrs. Grupe consulted

with her nephew, William Morris, an investment advisor, who again confirmed to her what she had learned respecting the quality and value of her debentures (A-252, 366).

Mrs. Grupe then made arrangements to meet with Mr. Lamula. She confronted him with the information that she had thus obtained, and insisted upon an explanation (A-253). Lamula protested that all of his actions with regard to Mrs. Grupe's portfolio were proper ones (A-867-8). He provided Mrs. Grupe with a handwritten statement of all transactions in her account (Plaintiff's exhibits 41A; E-10; A-370). Plaintiff asked Mr. Lamula to dispose of all of her debentures and to return her money, which he refused to do (A-260).

After further consultation with Mr. Morris, and refusal by defendants to rescind or dispose of the debentures for her, she at once made arrangements with Mr. Morris and (at his recommendation) with L. F. Rothschild & Co., a major New York investment banking and brokerage firm, for her portfolio to be entirely sold at the best prices then available (A-267).

The sale of her debentures yielded a net of aggregate principal proceeds amount of \$65,350. When subtracted from the aggregate cost of the debentures, plaintiff's net loss from the entire set of transactions was

\$31,350 (A-85). Plaintiff not only experienced an aggregate loss: she also experienced a loss with respect to the sale of each individual issue held by her. This action followed.

At the trial, in addition to witnesses of the events at issue, plaintiff offered the testimony of Harry C. Rowney, a vice-president of Drexel Burnham & Co., one of Wall Street's leading investment banking firms. Mr. Rowney, an investment counselor for twenty-three years (A-444-6), testified as an expert on the quality of the debentures (A-447-8), the state of the investment market in 1974 (A-449), the kinds of investment information appropriate for an unsophisticated investor such as Mrs. Grupe (A-489, 503), the standards employed in the investment counseling industry (A-468), and the risks inherent in holding debentures of such poor quality in a volatile market (A-479, 540-1).

Mrs. Grupe also offered the rebuttal testimony of John Angelo, chief arbitrage partner and principal junk bond trader of L. F. Rothschild & Co., who provided expert testimony as to the operations of the over-the-counter convertible debenture market (A-1150-3), the standard procedures for determining market price for junk bonds (A-1140, 1147-8), the proper use of the yellow sheets (A-1159-62), and an opinion as to the improbability of persistent one-way disparities between yellow sheet quotations and telephone quotations on

the same day (A-1144). Mr. Angelo also testified to the marketing technique used by L.F. Rothschild in disposing of Mrs. Grupe's debentures (A-1138-41).

Defendants offered no expert testimony at all on any of these issues, except that of Mr. Lamula himself.

The jury was given an extensive set of written special interrogatories pursuant to Rule 49(a), F.R.Civ.P. (set forth at A-1322-1336 and in the jury instructions). The interrogatories were fashioned by counsel for the parties in the first instance (A-815); and were revised and reshaped by the court (A-1164, ff.). These interrogatories related to liability only; counsel agreed to withhold damages questions from the jury until its posture on liability was established (A-1246-7). No objection was made to any interrogatory by defendants' counsel before the jury retired.

The presentation of the interrogatories was accompanied by detailed charges, both on general topics (such as witness demeanor and fraud), and as to the significance of each special interrogatory (A-1233-1277). Virtually all of the proposed charges requested by defendants were given to the jury verbatim (A-1098-1114).

The charges given included several pages on the subject of intent to deceive, suitability and the rules of

the NASD (A-1242-5, 1247-9). Defendants made no objection to any charge given before the jury retired.

The jury's answers to the special interrogatories established that:

¶The debentures were known or believed by defendants to be unsuitable to Mrs. Grupe; but, intending that she rely on him, Mr. Lamula recommended them to her anyway (Nos. I-1 and I-2).

¶Mrs. Grupe did rely on the recommendation (I-2).

¶With intent to deceive Mrs. Grupe, Mr. Lamula concealed from her other suitable investment opportunities (I-6(d)).

¶He also concealed from her how the debentures were rated (I-6(a)), that she could not expect a \$12,000 yearly income unless she bought speculative securities involving great financial risk (I-6(e), and that the debentures he sold her involved great risk (I-6(f)).

¶If any such information had been given her, Mrs. Grupe would not have purchased the debentures (I-8).

¶Mr. Lamula had almost complete control of pricing of debentures for sale to Mrs. Grupe (I-12(b)).

¶Clearly and convincingly, JLI overcharged Mrs. Grupe for the debentures, having first bought them specifically in order to sell them to Mrs. Grupe, and with intent to deceive her (I-13 and I-14).

¶Neither Mrs. Grupe nor L.F. Rothschild acted unreasonably in disposing of the debentures* (I-16 and I-17).

* Defendants-appellees' appeal counsel, who did not try the case, have clearly misread Interrogatory 16. At page 24, defendants-appellants' brief declares that the jury found that Mrs. Grupe did not act "reasonably" in disposing of the securities. An examination of the actual interrogatory (or a close examination of the reproduction thereof

The trial court determined that the findings evinced liability of both defendants for the fraud inhering in representing unsuitable securities as suitable ones, and in omitting material information with intent to deceive. Defendants' counsel agreed to, and accepted, the court's measure of damage as the difference between purchase price and sales proceeds, less net interest received by Mrs. Grupe on the debentures (A-1308-1310).

Accordingly, judgment was directed to be entered, computed under such formula (A-1317); and the jury was discharged.

Because the jury had found (a) that plaintiff was "almost entirely dependent" on defendants for the pricing of the debentures, and (b) that JLI's fraudulently excessive pricing was proven by "clear and convincing evidence" (I-12(b) and I-14), the touchstone for determining breaches of fiduciary duty and common law fraud, plaintiff moved post-trial to have her claim for punitive damages submitted to the jury (A-1315). The court denied that application (A-

which appears at A-1334) shows that Judge Goettel inserted the letters "un-" before "reasonably". The jury itself actually requested this insertion to make the interrogatory consistent with the following ones. The colloquy and a revised interrogatory (apparently overlooked by defendants' appeal counsel) appears at A-1292, line 23, to A-1293, line 20. See, also, Judge Goettel's comment at A-1297, lines 4-6.

1316).

Defendants moved for judgment n.o.v. or for a new trial pursuant to Rule 50(b), F.R.Civ.P., raising substantially the same arguments which are presented by them on this appeal (A-1341). Plaintiff cross-moved for costs including attorneys' fees, pursuant to §11(e) of the 1933 Act, contending that defendants' opposition to the excessive pricing count of the complaint bordered on frivolity (A-1343). Again, the court denied both the motion and cross-motion (A-1355).

ARGUMENT

I.

SINCE DEFENDANTS FAILED TO RAISE ANY OBJECTION BEFORE THE JURY RETIRED TO EITHER THE JURY INSTRUCTIONS OR THE SPECIAL INTERROGATORIES SUBMITTED TO THEM, DEFENDANTS THEREBY WAIVED THEIR RIGHT TO CLAIM THAT THE INSTRUCTIONS OR INTERROGATORIES WERE INADEQUATE.

A. Waiver

On this appeal, defendants have asserted either directly or by implication that the court failed to put special interrogatories to the jury on certain issues of fact and that it instructed them improperly as to certain matters of law. Thus, for example, defendants now aver that the findings of the jury on the questions put with regard to suitability are deficient. They contend that the jury charge was "misleading and inadequate" as to scienter, in light of Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S.Ct. 1375 (1976). And they also contend that the instructions as to mark-up and pricing of the debentures sold to Mrs. Grupe inadequately presented the applicable law.

We believe, however, that none of these matters can now be placed before this court for its review. The clear mandate of Rule 49(a) and Rule 51, F.R.Civ.P., is that any such objection must be raised before the jury retires, or it is deemed waived. It is clear that defendants had raised no objection to any interrogatory or to any aspect of

the instructions before the jury retired.* These rules are explicit:

"Rule 49. Special Verdicts and Interrogatories
... If [in submitting written interrogatories] the court omits any issue of fact raised by the pleadings or by the evidence, each party waives his right to a trial by jury of the issue so omitted unless before the jury retires he demands its submission to the jury. As to an issue omitted without such demand the court may make a finding; or if it fails to do so, it shall be deemed to have made a finding in accord with the judgment on the special verdict."

"Rule 51. Instructions to the Jury: Objection
... No party may assign as error the giving or the failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection."

The mandate of these Rules has long received the support of this and other courts. Thus, in Cote v. Estate of Butler, 518 F.2d 157 (2d Cir. 1975), the court affirmed the judgment appealed from as against the claim that certain questions were omitted:

"However, any objections [defendant] may have been entitled to make were waived by its subsequent failure to bring exceptions to the omissions to the attention of the trial judge. ... Indeed, after the verdicts had been returned, the court inquired if there were objections to the form of the verdicts and the appellant then stated only 'cross-claim, I think.' This late, vague objec-

* As indicated at pages A-1274 and 1275 of the Appendix, defendants' counsel actually did propose one amendment to Interrogatory No. 13. Plaintiff's counsel agreed to that change; whereupon the court amended that question (A-1277).

tion lacked sufficient clarity to apprise the trial judge of the alleged omission and prevents appellate review of the issue." 518 F.2d, at 160.

Accord, U.S. v. H.M. Branson Distributing Co., 398 F.2d 929 (6th Cir. 1968) (failure of appellants to submit or to object to any interrogatories); C. Albert Sauter Co., Inc. v. Richard S. Sauter Co., Inc., 368 F.Supp. 501 (E.D.Pa. 1973) (failure to object to an instruction before the jury retired); and Rubin v. U.S., 380 F.Supp. 1176 (W.D.Pa. 1974), aff'd 515 F.2d 507 (failure to object before the jury retired to questions or instructions), in each of which the court refused to consider substantive challenge after the jury returned its verdict. See, also, Turchio v. D/S A/S Den Norske Africa, 509 F.2d 101 (2d Cir. 1974) (waiver of right to appeal use by court of oral rather than written interrogatories, because of failure to object before jury retired).

Setting aside defendants' waiver of their objections for the moment, we contend that the findings of the jury were explicit or clear; and that they amply sustain a judgment against defendants for violation of the anti-fraud provisions of the securities laws. By the same token, we believe that the jury instructions given by the court below amply and correctly informed the jury as to the applicable law and the significance of the special interrogatories.

Thus, while other portions of this brief address the adequacy of the findings and instructions, and the support found in the record for the conclusions of both jury and judge (see Points II and III below), this court should not have to reach those arguments. The right to a jury trial would be undermined if litigants, having remained mute while the jury is instructed and given specific questions to answer, were to be entitled to appeal because, in hindsight, they regretted their earlier silence.

B. Judge-made findings

The final sentence of Rule 49(a) empowers the court to make a finding as to an omitted issue in conformity with the answers rendered by the jury to the questions which were submitted. Accordingly, even if one were to view the jury's findings in the case at bar as lacking a separate specific finding that defendants intended to deceive Mrs. Grupe by recommending debentures they knew to be unsuitable for her, such explicit finding of deceit was both implicitly and explicitly made by the court.

Thus, at page 1304 of the Appendix Judge Goettel made the following analysis of the findings:

"[Mr. Lamula] recommended unsuitable investments, and he knew that she would rely on his recommendations and did in fact so rely, and that he did not tell her about the ratings of these debentures or other suitable investments he could have made

or the risks involved, and that he did this with an attempt [sic; should read "intent"] to deceive, as to not telling her about other suitable investments: she wouldn't have purchased these securities otherwise. And that the company misrepresented the existing market price and the company and he, or Mr. Lamula, misrepresented the fact that they were purchasing these, at least two-thirds of them, to sell to her, and did so to deceive her. That's what they found."

Moreover, as the court discharged the jury, it declared:

"I followed your finding precisely. I think they make sense. There was a consistency of them ... The legal upshot of the findings you have made, factually, is that the defendant is guilty of statutory securities fraud." (A-1316).

To the extent that even these declarations are deemed deficient, the requirement of Rule 49(a) is that the deficiency be cured by a presumed finding. In Atlantic & Gulf Stevedores v. Ellerman Lines, 369 U.S. 355, 82 S.Ct. 780 (1962), the Court declared:

"Where there is a view of the case that makes the jury's answers to specific interrogatories consistent, they must be resolved in that way. For a search for one possible view of the case which will make the jury's findings inconsistent results in a collision with the Seventh Amendment." 369 U.S. at 364.

Accord, Gallick v. Baltimore & Ohio R. Co., 372 U.S. 108, 83 S.Ct. 659 (1963). The holding of these cases has been construed as a mandate to search for consistency, within the reasonable inferences to be derived from the proofs in the record. Jones & Laughlin Steel Corp. v. Matherne, 348 F.2d

394 (5th Cir. 1965); Black v. Riker-Maxson Corp., 401 F.Supp. 693 (S.D.N.Y. 1975); see, generally, 5A Moore's Federal Practice 2d Ed., ¶49.03 [4].

For the findings made by Judge Goettel or deemed to be supplied in order to provide consistency, the record in the case at bar provides ample support. It shows repeated material omissions by Mr. Lamula, whose business was showing large losses (A-724-5), in his dealings with Mrs. Grupe. The proofs show that the securities recommended and sold were speculative, risky and low-rated (I-1 and I-6; A-1322, 1327). And they establish ("clearly and convincingly") the motive for defendants' fraud: the chance for a money-losing concern to make an eleven percent profit through a risk-free sale (see Statement of Facts, above, passim).

C. No inconsistency in the jury's answers.

Nor do we find even the superficial inconsistency in the jury's answers which defendants claim to find. The nub of the alleged inconsistency, as defendants view it, seems to be that the jury found that defendants committed only some of the acts of fraud of which they were accused, and not all of them. We do not find it "inconsistent" that the jury specifically found that fraud had occurred by deliberate and deceitful omission, and not by active mis-

representation.*

Most important: defendants' brief is notably silent as to Interrogatory No. 2. Nowhere have they even mentioned that the jury found that Mr. Lamula, knowing or reasonably believing that the securities were in fact not suitable, nevertheless recommended them to Mrs. Grupe with intent that she rely -- a finding which enriches the scope of the jury's treatment of Interrogatories No. 1, 6 and 7.

Finally, the only two "inconsistencies" which defendants have actually adverted to were deemed such by their appellate counsel through his unfamiliarity with the record. First, the phrase, "almost entirely dependent", at the outset of Interrogatory No. 12 is misread by counsel as relating to the element of "reliance" in a cause of action for fraud. However, the question was actually structured to

* To be sure, we believe that the jury should have found both types of fraud to have occurred. We believe that the proofs of affirmative fraudulent misrepresentation were so convincing that it would have been error on the trial court's part not to have directed judgment for plaintiff n.o.v., if the jury had not itself returned a plaintiff's verdict. See, e.g., Mr. Lamula's own representations to Mrs. Grupe that the decline in value of the common stock did not adversely affect the value of the company's convertible debentures (A-924), that the omission of dividends on common and preferred stock made the debentures a "good buy" (A-956, 927-8), and that a depreciation write-off constitutes a cash reservoir actually held by the corporation as "money that stays in the till" (A-959).

deal with the elements of a cause of action for "breach of fiduciary duty" (see colloquy benchside at A-1167, lines 5 to 20); and the court so instructed the jury when the Interrogatory was submitted. (A-1261.)

Second, as describe in the footnote on pages 19 and 20 of this brief, supra, counsel failed to observe that the court converted the word "reasonably" in Interrogatory No. 16 to read "unreasonably". That Interrogatory, therefore, fully harmonizes with Interrogatory No. 17 and explains the language of Interrogatory 18 (A-1292-3).

In sum, defendants have no right as matter of law to raise at this point any objections to the Interrogatories or to the Instructions, nor have they any cause to do so as a matter of fact.

II.

THE FINDINGS OF THE JURY AMPLY SUPPORT JUDGMENT FOR PLAINTIFF FOR THE FRAUD COMMITTED BY DEFENDANTS IN (a) RECOMMENDING TO HER DEBENTURES WHICH THEY KNEW TO BE UNSUITABLE FOR HER, (b) OMITTING TO INFORM HER OF OTHER MATERIAL MATTERS WITH INTENT TO DECEIVE HER, AND (c) DELIBERATELY OVERCHARGING HER FOR THE DEBENTURES WITH INTENT TO DECEIVE HER

A. Securities Law Fraud.

If we correctly interpret defendants' principal argument, it is that the jury did no more than find that the debentures were not suitable for plaintiff; and the Court therefore improperly determined that the anti-fraud provisions of the federal securities laws* were violated. Only by deliberately ignoring the jury's response to Interrogatory No. 2 can such an argument be advanced; for there the jury specifically found:

"[t]hat Mr. Lamula knew or reasonably believed that the debentures were unsuitable for Mrs. Grupe when he recommended that she buy them, and that he intended that she rely upon his recommendation, and that in fact she did rely on him in buying them". (A-1323)

More: Such an argument also ignores the jury's express findings that defendants deliberately omitted to advise

* Reproduced in Supplement No. 1 hereto.

Mrs. Grupe of four factors material to her investment decision (Interrogatory Nos. 6 and 8; A-1327, 1329); and that this was done with intent to deceive Mrs. Grupe (Interrogatory No. 7; A-1328). The argument also ignores the obvious impact which defendants' fraudulent and improper mark-up activities had upon the jury, in establishing "clearly and convincingly" the existence of a motive for the fraud (Interrogatory Nos. 12(b), 13 and 14; A-1331-3).*

Such findings, it is well established, fully support a judgment for violation of those anti-fraud provisions of federal law upon which plaintiff here relies. In light of Affiliated Ute Citizens of Utah v. U.S., 406 U.S. 128 92 S.Ct. 1456 (1972), it is far too late to contend that deceitful failure on the part of a seller of securities to advise the purchaser of material matters does not constitute a violation. The concealment of or omission to provide rating information, it has repeatedly been held, constitutes a material misrepresentation or omission, violating Section 17(a) of the 1933 Act and Rule 10b-5. S.E.C.

* It should be especially noted that defendants have nowhere claimed that any of the findings which favored plaintiff, made by the jury in response to the Interrogatories, was not supported by sufficient evidence in the record. Even though this appeal thus does not require a search of the record for proof supportive of the findings, the Court must nevertheless view the evidence in the light most favorable to plaintiff. Taxi Weekly, Inc. v. Metro. Taxicab Bd. of Trade, 539 F. 2d 907 (2d Cir. 1976); Collins v. Penn Central Transportation Co., 497 F. 2d 1296 (2d Cir. 1974).

v. Charles A. Morris & Assoc., Inc., 396 F. Supp. 1329 (W.D. Tenn. W.D. 1973). In Hanly v. S.E.C., 415 F. 2d 589 (2d Cir. 1969), the Court quoted with approval the following excerpt from the Commission's opinion:

"It is clear that a salesman must not merely avoid affirmative misstatements when he recommends the stock to a customer; he must also disclose material adverse facts of which he is or should be aware." 415 F.2d, at 592 (quoting from pp. 7-8 of Richard J. Buck & Co., Sec. Exch. Act. Rel. No. 8482).

Accord, Charles Hughes & Co. v. S.E.C., 1939 F. 2d 434 (2d Cir. 1933) ("the essential objective of securities legislation is to protect those who do not know market conditions from the over-reaching of those who do."); 1 Bromberg Securities Law: Fraud -- SEC Rule 10b-5, Section 5.5, p. 101 (1975) (the standard applicable to a broker-dealer is especially high where the securities in question are traded, as here, over the counter); Hughes v. S.E.C., 174 F. 2d 969 (D.C. Cir. 1949) (broker-dealers are held to highest standards of disclosure when publicly available information about the securities is sparser and where the customer cannot be expected to have the means and facilities to verify what he is told); Franklin Savings Bank of N.Y. v. Levy, ___ F.2d ___, CCH Fed. Sec. L. Rep. ¶95,902 (2d Cir. 1977) (a dealer's representation as to a security's quality is an implied representation that he has an adequate basis in fact for saying so).

The jury's responses to the Interrogatories in the case at bar provide all of the elements of a standard Rule 10b-5 violation. The jury affirmatively found: material omissions (I-6), I-8); material misrepresentations (I-2); reliance (I-2);* and damage (I-16, I-18; see Point IV, infra.).

This leaves scienter. In our view of the case, the findings fairly drip with it. Not only did the jury twice expressly find intent to deceive in their answers to Interrogatory Nos. 6 and 13c; but there is no other fair reading which can be applied to Interrogatory No. 2 than that Mr. Lamula intended to deceive Mrs. Grupe when, knowing that she would rely upon him, and knowing that the securities were not suitable for her, he nevertheless recommended that she buy them.

Defendants have made reference to Ernst & Ernst v. Hochfelder, 425 U.S. 185; 96 S.Ct. 1375 (1976), as if to infer that that decision so constricted the scope of fraud under the federal securities laws as to deprive plaintiff of relief in the case at bar. We cannot believe that this is so. Here, where the intent to deceive was transparent, was proven and was found, the limitations imposed by the Supreme Court in Hochfelder simply have no bearing.

In Hochfelder, the plaintiff conceded that there

* To the extent that the fraud is perpetrated through omissions, it is well established that reliance need not be shown where materiality is established. Affiliated Ute, Citizens of Utah v. U.S., supra, 406 U.S. 128 (1972).

was no intent to deceive, only negligence. The plaintiff in Hochfelder was an alleged aider and abettor; here, the fraud arose in direct seller-to-buyer dealings. As if these were not enough distinguishing features, we must note that the Supreme Court itself, in footnote 12 of the opinion, 425 U.S. at 193, specifically declined to give content to scienter; it held only that negligence was not enough. Indeed, in that footnote, the Supreme Court seemingly endorsed the doctrine enunciated by this Court in Lanza v. Drexel & Co., 479 F. 2d 1277 (2d Cir. 1973), that willful or reckless disregard of the truth constituted scienter.*

We have carefully examined the proliferation of comments and opinions interpreting Hochfelder, supra, which have been written in the year since that opinion was rendered by the Supreme Court. See, e.g., Goldwassser, "Ernst & Ernst v. Hochfelder: an Anti-Landmark Decision", 22 N.Y. Law School L. Rev. (1976); Patrick, "New Directions and Recent Developments in Securities Litigation", in Eighth Institute on Securities Regulations PLI Handbook No. 224 (1976) at p. 276; Sanders v. John Nuveen & Co. Inc., ____

* Thus, the Supreme Court can be said to have endorsed the classic definition of Derry v. Peck, 14 App. Cas. 337, 374 (H.L. 1889): "... (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false." See, also, Ultramares Corp. v. Touche, 255 N.Y. 170, at 189 (1931) ("reckless misstatement" or "insincere profession of an opinion" will suffice); State Street Trust Co. v. Ernst, 278 N.Y. 104 (1939), rearg. den., 278 N.Y. 704; Jo Ann Homes at Bellmore v. Dworetz, 25 N.Y. 2d 112 (1969).

F.2d ____, CCH Fed. Sec. L. Rep. ¶96,030 (7th Cir. 4/22/77). We note, for example, that this Court in Arthur Lipper Corp. v. S.E.C. __ F.2d ____, CCH Fed. Sec. L. Rep. ¶95,796 2d Cir. 1976, rejected the contention that Hochfelder required intention to violate the law. We observe in Franklin Savings Bank v. Levy, supra, that this Court reaffirmed that a broker-dealer impliedly represents that he has an adequate basis in fact for the opinion he renders, and that a failure to exercise reasonable professional care in recommending securities can be deemed "misleading", in the federal securities law sense.

The temptation is great to distinguish Hochfelder exhaustively. But that is not necessary here. This case does not involve matters merely "tantamount" to fraud; it involves standard, garden-variety fraud, of the kind repeatedly found to violate the anti-fraud provisions of the federal securities laws. See, e.g., Opper v. Hancock Securities Corporation, 250 F. Supp. 668, 673 (S.D.N.Y. 1966) aff'd. 317 F.2d 157 (2d Cir. 1966).

Thus, with all the shades of meaning at the outer borders of Hochfelder, this Court need not tarry. The parameters need not be probed; for the findings of the jury drove to the heart of securities fraud doctrine.

B. Violation of NASD Suitability Rule.

It should not be necessary in light of the apparent statutory violations which occurred here, to dwell at length upon the actionable violations of the NASD Rules of Fair Practice suitability provision.* However, not only are the NASD suitability standards relevant to the determination of what a broker-dealer is obliged to do when making recommendations, but they also provide a basis in certain cases for a judgment for securities law fraud.

As Judge Goettel quite properly charged the jury below:

"The rules of fair practice of the National Association of Securities Dealers may be considered by you as an expression of the security industry itself concerning what constitutes proper conduct, and the violation of those rules under certain circumstances amounts to fraud under the federal securities laws and under the New York State law as well." (A-1249-50).**

Suitability of investments, as a standard for conduct in the securities industry, is not expressly referred to in the 1933 and 1934 Acts, or in the Rules promulgated

* Art. III, Section 2; see Supplement No. 1, infra.

** Again, we note defendants' failure to object to this instruction.

by the S.E.C. thereunder. It appears textually only as a mandate of Section 2 of Article III of the NASD Rules of Fair Practice. Under this Rule, the broker-dealer is under an affirmative duty to have reasonable grounds for believing that a recommended security is suitable for the customer.

It is not enough, then, for a broker-dealer to have no reason to believe that a security he recommends is not suitable: he is mandated to form his own reasonable belief as to suitability. We think the proofs in the instant case established that defendants failed to discharge this express duty of fair-dealing.

The law in this Circuit, since Colonial Realty Corp. v. Bache & Co., 358 F.2d 178 (2d Cir. 1966), cert.den 385 U.S. 817 (1966), has been that a private civil cause of action under the 1933 and 1934 Acts will arise from violation of an NASD Rule, if the rule creates, in the regulatory scheme, "an explicit duty unknown to the common law." 358 F.2d, at 182. Such a specific duty as we have described in the immediately preceding paragraph of this brief was unknown to the common law. See Lowenfels, Private Enforcement in the Over-the Counter Securities Markets: Implied Liabilities Based on NASD Rules, 51 Cornell L.Q. 663 (1966); Lowenfels, Implied Liabilities Based Upon Stock Exchange Rules,

66 Colum.L.Rev. 12 (1966); Note, Implied Civil Liability Arising From Violation of the Rules of the NASD, 8 Loyala L. A. L. Rev. 151 (1975).

In Van Gemert v. Boeing Co., 520 F.2d 1373 (2d Cir. 1975), the court reaffirmed the Colonial principle:

"We extended (the rule sustaining implied private civil liability)... at least by dictum to include violation of stock exchange and securities dealers' association rules designed for the direct protection of investors ..., in Colonial Realty Corp. v. Bache & Co. ..." 520 F.2d, at p. 1380.

See also, Evans v. Kerbs & Co., 411 F.Supp. 616 (S.D.N.Y. 1976); Starkman v. Seroussi, 377 F.Supp. 518, (S.D.N.Y. 1974); Bush v. Bruns Nordeman & Co., CCH Fed. Sec. L. Rep., ¶93,675 (S.D.N.Y. 1972); Buttrey v. Merrill Lynch, 410 F.2d 135 (7th Cir. 1969); compare Architectural League of N. Y. v. Bartos, 404 F. Supp. 304, (S.D.N.Y. 1975).

Even though Ernst & Ernst v. Hochfelder, supra, 425 U.S. 185, 96 S. Ct. 1375 (1976), has chilled the radiations of 10b-5 fraud concepts somewhat, we believe that the Colonial Realty doctrine still retains substantial vitality, particularly in cases of the kind presented here.

Thus, in Rolf v. Lyth Eastman Dillon & Co., Inc. CCH Fed. Sec. L. Rep. ¶95, 843 (S.D.N.Y. 1/18/77), Judge Pierce expressly found that inaction by a broker in the face

of patently unsuitable transactions violated NASD Art. III, Section 2, and thus supported a claim of violation of the anti-fraud provisions of the 1934 Act. See, also, Neill v. David A. Noyes & Co., 416 F. Supp. 78 (N.D. Ill. 1976), (complaint alleging bare violation of stock exchange rules and deceit adequately pleaded 1934 Act violation).

The cases cited by defendants in their brief are in large distinguishable from the case at bar. In Utah State University v. Bear, Stearns & Co., 549 F. 2d 164 (10th Cir. 1977), for example, the court dismissed the complaints because none even pleaded overreaching, manipulation, deception. The court there, however, expressly reaffirmed its pre-Hochfelder dictum in Ocrant v. Dean Witter & Co., 502 F. 2d 854 (10th Cir. 1974), that "in an appropriate case, violations of exchange rules designed for customer protection might give rise to a private cause of action". Id. at 858. In Parsons v. Hornblower & Weeks, CCH Fed. Sec. L. Rep. ¶95, 885 (M.D.N.C. 1977), the court found no showing to support the alleged misrepresentations and omissions.

Judge Goettel's opinion on the motion for judgment n.o.v. in the case at bar (A-1355-6) provides an interesting insight. The court suggested that, when the case involves direct dealer-to-customer contact, "the plaintiff makes a case by showing the misleading statements and reliance and ...

the burden then shifts to the defendant to establish that the misleading was unintentional and negligent." Something of the same view emerges from Plunkett v. Dominick & Dominick, CCH Fed. Sec. L. Rep. ¶95,728 (D.C. Conn. 1976), also cited by defendant.

In any case, as Judge Goettel observed, the jury findings at bar indicate that they found scienter (A-1356). In combination with a finding of unsuitability it should be enough.

C. Suitability and Subsequent History.

Defendants urge that suitability must be determined in light of the subsequent market history of the debentures sold to Mrs. Grupe.

In the first place, defendants raised no objection to the court's exclusion of the subsequent history testimony relating to times long after the sale (A-618-19). Nor did they make a tender of proofs, so that the court might consider what validity remote history might have. Without such a tender, they cannot claim reversible error here. Rule 103(a), Federal Rules of Evidence. Second, the trial Court actually permitted Mr. Lamula to testify as to matters occurring "shortly after [the purchase by Mrs. Grupe] and for a continuing period of time" (A-618, lines 24-5); and such testimony was received (A-619-623).

Third, defendant's trial counsel acknowledged the correctness of Judge Goettel's ruling on the record:

"The Court: I thought you were in agreement that the suitability of debentures has to be evaluated as of the time [of] purchase.

Mr. Goldstein: Yes, there is no question on that. There has been some testimony as to what happened with these companies afterwards in an attempt to show whether they were suitable or not, on both sides."
(A-885)

We think law and logic support a rule limiting proof of suitability by subsequent history proof. As was said in Pittsburgh Coke & Chemical Co. v. Bollo, 421 F. Supp. 908 (E.D.N.Y. 1976):

"For purposes of a Rule 10b-5 claim, events occurring after the commitment to purchase stock has been made are irrelevant. Issues of non-disclosure, misrepresentation, materiality and reliance are to be determined by the situation and knowledge of the parties at the time they committed themselves, and not on the basis of subsequent events..."
Id., at 923.

Cf. Harris v. American Investment Co., 523 F.2d 220 (8th Cir. 1975), cert. den. 423 U.S. 1054, 96 S. Ct. 784 (1976); Cant v. A. G. Becker & Co., Inc., 379 F. Supp. 972 (N.D. Ill. 1974).

As a matter of logic, the concept will not wash. We can think of no reason why defendants, if they defrauded Mrs. Grupe into buying these bonds, should be able to avoid

liability by asking Mrs. Grupe to wait for a market turn. Under such a theory, what value would a right of rescission have, when fraud is discovered? And when would the statute of limitations start to run--only when defendants conceded that their fraud was irreparable?

Judge Goettel stated succinctly the reason why suitability should be judged under conditions as they were when the recommendation was made; we cannot improve on his explanation:

"The Court: I think we ought to explain to the jury, though, this is a matter of hindsight and that in terms of what appeared appropriate at the time, you had to deal with the information then available. The fact that several of these companies may have in fact done extremely poorly is hindsight, just as the fact that some of them may have come out quite well is also hindsight, and that an investment counsellor or that an investment adviser has to act on the information then available."
(A-542-3)

III

THE COURT BELOW PROPERLY APPLIED
THE LAW RESPECTING DEFENDANTS'
PRICING OF THE DEBENTURES ON
THEIR SALE TO PLAINTIFF; AND
THE JURY PROPERLY FOUND THAT
DEFENDANTS' PRICING PRACTICES
WERE WRONGFUL AND FRAUDULENT

The prices at which JLI sold the debentures to Mrs. Grupe were found to be excessive (I-13a; A-1332). Defendants sold the debentures to plaintiff for their personal profit, and had sole control over the price to be charged (I-12b and 13; A-1331-2).

Article III, §4 of the NASD Rules of Fair Practice, and the Policy Statement issued thereunder by the Board of Governors of the NASD (collectively referred to herein as the "NASD Markup Rules"), require a dealer, selling for his own account to his customer, to

"...buy or sell at a price which is fair, taking into consideration all relevant circumstances..." CCH NASD Manual, ¶2154.

The evidence, and the admissions made by defendants in response to plaintiff's Request to Admit, established that the markups taken by defendants ranged from a low of 7.12 percent to a high of 20.5 percent; and that they averaged 11.78 per issue. Thus, the NASD's five percent "guide" (CCH NASD Manual, ¶2154) was substantially exceeded with every single purchase.

Moreover, of the additional markup factors listed by the NASD Board (*id.*), all those relevant in the instant dispute tend to indicate that a markup of much less than five percent, not more, should obtain here. These transactions were in debt securities, not common stocks; here, defendants had two full months to assemble the portfolio, and thus the securities were "available"; here, each unit of debentures traded at a price of several hundred dollars, rather than for only a dollar or two, like "penny stock". Here, the entire transaction involved more than \$100,000, and not just a minor sum; here, defendants deliberately concealed from plaintiff any information about the price of the individual debentures until the transactions had occurred; here, defendants provided no usual or extensive research, custodial or other services warranting extra mark-ups.

The taking of excess markups constitutes violation of the anti-fraud provisions of the 1933 and 1934 Acts, and Rule 10b-5. Opper v. Hancock Securities Corp., *supra*, 250 F.Supp. 568 (SDNY 1966), *aff'd*. 367 F.2d 157 (2d Cir. 1966); 1 Bromberg, *op.cit. supra*; §5.2 at pp. 92-95; Boren & Co., 40 S.E.C. 217 (1960); Naftalin & Co., Inc., Sec. Exch. Act. Rel. No. 7220 (1964). Accord, Merritt, Vickers, Inc. v. S.E.C., 353 F.2d 293 (2d Cir. 1965); Charles Hughes & Co. v. S.E.C., *supra*, 139 F.2d 434 (2d Cir. 1943);

"... it was still under a special duty, in view of its expert knowledge and proffered advice, not to take advantage of its customers' ignorance of market conditions ... when nothing was said about market price, the natural implication in the untutored minds of the purchasers was that the price asked was close to the market. The law of fraud knows no difference between express representation on the one hand, and implied misrepresentation or concealment on the other." 139 F.2d, at 437.

Considering that most of the debentures were bought and sold by JLI in what amounted to same-day transactions, the Court properly charged the jury as to the manner of determining whether the prices were excessive (see A-1264-6 and A-1275-6).

It has been repeatedly held that, when the securities actually sold were acquired by the dealer on or near the date of their sale, or in a "work-out" situation, the percentage of the markup will be determined by referring to the dealer's contemporaneous cost for the securities in question. Shearson Hammill & Co., S.E.C. Sec. Act. Rel. No. 7743, CCH F.Sec.L.Rep. ¶77,306 (1965); see, also, Naftalin & Co., Inc., supra.

With defendants herein, the evidence of fraudulent pricing practices was even more blatant. The proofs here establish that JLI's file notations as to purported quotations given by other market makers are false (see, e.g., A-1147, 1149). The yellow sheets themselves for the days in question establish that, in virtually every instance,

the alleged quotations of the market makers which were recorded by defendants on the Grupe order tickets are widely at variance from the quotations inserted by such market makers in the sheets -- and always on the high side! (Plaintiff's exhibit 165; E-11)

Moreover, defendants themselves inserted quotations on several of the same debentures at prices substantially less than those they charged to plaintiff. Skewed prices by a dealer have routinely been found to constitute violations of the anti-fraud provisions of the securities laws, as well as violations of the NASD Markup Rules.* Opper v. Hancock Securities Corporation, 250 F.Supp. 668 (S.D.N.Y. 1966), aff'd 367 F.2d 157 (2d Cir. 1966).

Thus, the proper measure to be used to gauge markup in this case is defendants' actual cost for the debentures sold. Measured from such a base, the markups were egregiously excessive.

We note, further, that the jury found breaches of common law fiduciary duty, as well as common law fraud (I-12b; I-14): almost complete dependency on defendants for the pricing, and clear and convincing proof of fraud in all its elements. We do not know what defendants are

* Indeed, such practices raise questions of the violation of Article III, §5 of the NASD Rules of Fair Practice, prohibiting the issuance of quotations unless they are bona fide. CCH NASD Manual, supra, ¶2155.

driving at in referring to these legal principles; for such breaches entitled plaintiff to an award of punitive damages. Lehrmann v. Merrill Lynch, 175 N.Y.L.J. No. 36, p. 7 (Sup. N.Y. 2/24/76); Brown v. Coates, 253 F.2d 36 (D.C. Cir. 1958).

Finally, we believe that, as Point I, supra, demonstrates, defendants are foreclosed from challenging the trial court's "interpretation" of these principles, because no Rule 51, F.R.Civ.P. objection was made before the jury retired.

IV.

PLAINTIFF'S DAMAGES WERE PROPERLY MEASURED.
IN ANY EVENT, THE MEASURE OF DAMAGES AP-
PLIED BY THE COURT WAS EXPLICITLY AGREED TO
BY DEFENDANTS.

Given a finding that the anti-fraud provisions of the federal securities laws were violated by defendants, and that Mrs. Grupe would not have bought the debentures if defendants had advised her of the material matters which they were found to have concealed from her, the court fixed the damages as the difference between (a) the purchase price she paid for the debentures, and (b) the proceeds she received upon her sale of the debentures promptly after learning that she had been defrauded.*

Defendants' counsel specifically endorsed and approved this method of determining damages. After the jury returned with its answers to the questions given it, a colloquy was held by court and counsel in the robing room (Appendix, commencing at page A-1308). The court directly asked defendants' counsel:

"... Do you agree that if [the jury] found for her on the statutory fraud claim, that the damages are that figure, \$32,000; something like that?"

* The court adjusted this amount to take into account the net interest received by Mrs. Grupe from the debentures, and the net interest paid by Mrs. Grupe with respect to the loan she took against her \$100,000 certificate of deposit (A-189-190).

After further colloquy:

"Mr. Goldstein: On statutory fraud, I agree, it would be 32, except I think she would have to give him credit for the money she made, the dividends."

After further colloquy respecting the elements entering into the computation, the court set forth its proposed formula for the judgment (A-1314), utilizing the measure above described. With the agreement of both counsel, the court proceeded to the bench and announced the formula to the jury (A-1317) just before the jury was discharged.

In light of this agreement of their counsel, defendants should not now be heard to question the measure of damages.

In any case, the measure of damages applied at bar was proper. In Chasins v. Smith, Barney & Co., 438 F2d 1167 (2d Cir. 1970), the court determined that plaintiff was entitled to receive as damages

"...the difference between the purchase price to Chasins... and the amount Chasins received when he subsequently sold the securities..." at p. 1173.

There, Chasins sold the securities even before he learned of defendant's wrongdoing; there, Chasins acknowledged that the price he paid to defendant (a concealed market maker) was fair. The court held the measurement justified

"...where, as here, the evil is not the price at

which Chasins bought but the fact of being induced to buy..." Id.

It seems simple a fortiori reasoning in the case at bar, where Mrs. Grupe's purchase price was far above fair market value, and where she sold out her holdings immediately upon first discovery of the deceptions practiced upon her as to suitability, that the same measure would obtain. Butkowsky, "Remedies for Violations of Rule 10b-5 in General," in P.L.I., The 10B Series of Rules, 1974.

The Chasins rule is firmly rooted in this and other circuits: it has been repeatedly held that a defrauded buyer is entitled, under Section 28(a) of the 1934 Act (15 U.S.C. §78bb(a)), to rescissory damages. Thus, in Abrahamson v. Fleschner, 392 F. Supp. 740 (S.D.N.Y. 1975) the court declared:

"While 'actual damages' has been most often translated as 'out of pocket loss', Section 28(a) has been interpreted to allow a defrauded buyer to choose rescission instead of the difference between the value of what he gave up and the value of what he received..." 392 F. Supp., at 746.

Accord, Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975); Sarlie v. E. L. Bruce Co., 265 F.Supp. 371 (S.D.N.Y. 1967); 3 Bromberg, Securities Law: Fraud SEC Rule 10b-5, §9.1, pp. 226-7.

From an initial diffidence about according defrauded buyers the same measure of relief as defrauded sellers, the courts have moved to equate the remedial concepts. See, e.g.,

Zeller v. Bogue Electric Manufacturing Corp., 476 F.2d 795 (2d Cir. 1973). Indeed, as appears in Zeller, the thrust of the opinions now is to develop ways of expanding a plaintiff's relief in securities fraud cases. See especially Zeller, supra, at footnotes 10 and 11, 475 F.2d, at 802-3. In the instant case, plaintiff's prompt sale of the debentures-- a sale which the jury found to have been reasonable*--closed the transaction. Thus application of either the out of pocket loss or the rescissory measure produces the identical result at bar.

Defendants have confused the issue by reference to damage concepts in market manipulation situations. The sole authority cited by them on this point (Cutner v. Fried, 373 F. Supp. 4 (S.D.N.Y. 1974)) is such a case**. But in such cases, the nature of the fraud requires a plaintiff to establish that his loss was caused by the market price maneuvers in question. No such charge is made here: all of the fraud complained of was leveled by defendants solely and directly at Mrs. Grupe herself. Consequently causation is not in issue.

*See Point I(C), supra, footnote on pages 19 and 20, and the jury's answers to questions 16 and 17 (A-1334-5).

**The Cutner case is cited wholly out of context. There the issue was determining the validity and size of a class in a class action. Plaintiff claimed that alleged manipulations and a suspension of trading caused a price drop in the stock of Skyline Corp., forcing some margined shareholders of Skyline to sell. We see no relevance to the instant case.

Nor do we see any merit in defendants' assertion that plaintiff failed to mitigate, and their concomitant implication that she might have suffered less if she stayed at risk longer: (1) the jury found plaintiff's resale of debentures to have been reasonable; and (2) the testimony of plaintiff's expert, Mr. Rowney, fully supported the wisdom of that finding (A-540-1).

Moreover, the court did not prevent defendants from showing, if they could, that the fair values of the debentures at the time of their sale were different from those Mrs. Grupe received through L. F. Rothschild. Indeed, defendants started down that road (A-893, line 21 to A-894, line 24); but never did they proffer any such evidence. Under the circumstances, therefore, the trial court had before it no market value issue relating to Mrs. Grupe's sales of the securities. Hence, there was nothing of that order for the jury to consider.

V.

NO CLAIM OF PREJUDICE WAS RAISED AT TRIAL RESPECTING USE OF THE MARKET TERM "JUNK BONDS". FOR THIS REASON, AND BECAUSE THE TERM WAS CLEARLY NOT PREJUDICIAL TO DEFENDANTS, NO PLAIN ERROR WAS COMMITTED BY THE TRIAL COURT.

Defendants aver that use of the term "junk bonds", a phrase of standard parlance in Wall Street for debt security rated BAA or less*, is error providing grounds for reversal. We submit that no such grounds exist.

Under Rule 103(a)(1), Federal Rules of Evidence,

"Error may not be predicated upon a ruling which admits...evidence unless a substantial right of the party is affected, and... a timely objection or motion to strike appears of record, stating the specific ground of objection... ."

Defendants never challenged the use of such term by any witness, or by the court. During the opening remarks of plaintiff's counsel, to be sure, defendants' counsel complained that the term was in the nature of "summation", not proper opening; and the court admonished plaintiff's counsel to stay strictly to matters to be proved (A-128-9). When proof of the term was subsequently offered through experts (A-448,1134-5), no objection whatever was raised; nor was such objection raised at any other time until this appeal. In fact, the complaint itself put defendants on

* See testimony, A-1134.

notice that precisely this proof would be offered at trial (§12 of complaint; A-7); hence there can be no valid reason for their not being prepared to object specifically to the proof tendered.

Nor did defendants even offer or ask a cautionary instruction to the jury. Indeed, defendants' trial counsel himself made repeated use of the term on summation, in order to discredit the experts Rowney and Angelo because they dealt in "junk" (A-1188).

Both the failure to object or seek limiting jury instructions, and the effort to use the term to their own advantage, constitute waivers by defendants of the opportunity to assign error to the nomenclature now. 1 Weinstein's Evidence, §103[02], pp. 103-14 et seq. The discussion in that treatise at the indicated paragraph, and at §103[04], p. 103-36 et seq., emphasises that the objection must be clear and specific, and neither waived by conduct nor silence. We think that the waiver of this purported error in the case at bar is obvious.

To be sure, subdivision (d) of Rule 103, F.R.E., provides that a reviewing court is not precluded from "taking notice of plain errors affecting substantial rights," even though not raised before the trial court. However, the clear indication of the cases is that appellate courts in civil appeals are particularly reluctant to exercise their

discretion in the matter; and rarely find adverse effect upon "substantial rights". 1 Weinstein's Evidence, supra, ¶103.07, at pp. 103-61 et seq.

Thus, while the rule has been applied in a criminal case where "a decisive issue of substantive law [was] ignored below" (id., citing U.S. v. Alsondo, 486 F. 2d 1339, 1344 (2d Cir. 1973)), we have not found a decision, after diligent search, where a "plain error" reversal was granted by a circuit court on a comparable basis; and defendants have pointed to none. The reluctance to intervene and reverse which should guide an appellate court in areas of trial court discretion has been amply declared by this court in Napolitano v. Compania Sud Americana de Vapores, 421 F. 2d 382 (2d Cir. 1970); the significance of the evidence rejected there surely far surpassed any minimal potential for prejudice in the case at bar; cf. Peter Eckrich and Sons, Inc. v. Selected Meat Co., 512 F. 2d 1164 (7th Cir. 1975).

Finally, we do not see how "substantial" rights of defendants were affected improperly so as to warrant reversal. The other proofs of non-suitability of the debentures were overwhelming (see Appendix references in Statement of Facts, supra, pages 9-10; Supplement No. 2, infra); the testimony of Messrs. Rowney, Lamula and Angelo directed thereto covers easily 375 pages of transcript -- fully one-third of the entire trial. Defendants themselves proposed

to produce, as experts on suitability, a "member" of Moody's, a "member" of Standard & Poor's, and "an expert [not otherwise identified] in bond and debenture transactions in the securities industry" (A-100-101); but voluntarily withdrew all such proffers in mid-trial.

The term "junk bond" is one which, like "penny stock", has become firmly imbedded as a term of art in Wall Street. While the term may indeed be somewhat descriptive of the quality of the securities (but see testimony A-1135), so also is penny stock. Cases abound in which courts and other tribunals have used such terms (see, e.g. Samuel B. Franklin & Co. v. S.E.C., 290 F. 2d 719,725 (9th Cir. 1961), cert. den. 368 U.S. 889, 82 S. Ct. 142 (1961); Handley Investment Co. v. S.E.C., 354 F. 2d 64 (10th Cir. 1965)); but apparently no one before has claimed reversible error on such account.

In short, the jury finding of unsuitability (I-1) was so obviously well-based that the occasional use of a standard term of Wall Street parlance should not in any case provide leverage to overturn it.*

* We see no merit to defendants' claim that certain humorous comments by the trial court afford a basis for reversal (appellants' brief, p. 22, bottom paragraph). Apart from defendants' failure to object to such matters at the trial, we think it apparent that these comments were (a) not prejudicial to defendants in any way, (b) unrelated to plaintiff's substantial rights, and (c) in the context of a trial transcript of 1,200 pages' length, were perhaps (if anything) a much needed leaven. In any event, defendants have cited no case in which an appeals court has gone so far; nor do we have knowledge of any.

CONCLUSION

For the reasons set forth in this brief, the appeal should be dismissed and the judgment below (and the order denying judgment n.o.v. or a new trial) affirmed, with costs and disbursements to plaintiff.

Respectfully submitted,

SILBERFELD, DANZIGER & BANGSER
Attorneys for Plaintiff-Appellee
230 Park Avenue
New York, New York 10017
(212) 867-6500

Robert M. Blum
Robert M. Dubow
Of Counsel

SUPPLEMENT NO. 1

Section 17(a) of the 1933 Act

Sec. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

- (1) to employ any device, scheme or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 10(b) of the 1934 Act

Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

- (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 15(c) (1) of the 1934 Act

(c) (1) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member by means of any manipulative, deceptive, or other fraudulent device or contrivance, and no municipal securities dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this paragraph, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

Rule 10b-5

Reg. § 240.10b-5. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Rules of NASD, Article III, Section 2

Sec. 2. In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

SUPPLEMENT NO. 2

All numbers are references to Appendix pages.

1. Companies in serious economic difficulty:
913, 916, 945, 949, 959
2. Companies had shown net losses for recent and
current periods:
482-4, 916, 942, 945
3. Companies not declaring dividends:
916, 929, 932, 937, 939, 956, 962, 964, 970
4. Convertibility feature meaningless:
477-8, 922, 967
5. Thin market builds in loss:
464, 465, 539-40, 933, 963
6. JLI was principal, not broker:
Pre-trial order agreed facts ¶9 (A-67)
7. Major litigation pending:
508, 512-13, 944, 969
8. Poor ratings of debentures:
479-82, 909